

SCOPE PAPER

Defense Conversion Committee Report Session

1. Objectives for the Meeting

The Defense Conversion Committee's goals for this meeting are to review progress on existing programs, including Nunn-Lugar fast-track projects and programs of other U.S. government agencies in defense conversion, and steps the sides have taken to complement these efforts with technical assistance programs, political and economic reforms, and measures to promote foreign investment in converting Russian defense firms; to announce new programs, which emphasize trade and investment rather than direct government funding; and to respond to Russian ideas for a Committee role in facilitating the use of dual-use technologies previously developed by Russian defense enterprises in future cooperative defense conversion projects. The Russians will use this meeting to press us for assurances that planned Nunn-Lugar conversion projects for the coming year, in particular the housing industry project and assistance for industrial partnerships from the list of 82 eligible Russian defense enterprises, will be funded. They also are expected to use the meeting to press for greater Russian control over the selection of defense conversion projects supported by U.S. industry.

2. Overview and status of key issues

a. Key issues.

The Report to the Commission outlines progress in cooperation in Nunn-Lugar pilot projects for defense industry conversion. It notes the importance of moving ahead with the prefabricated housing industry and list of 82 projects when funding is available. However, neither may move ahead until Russia has been certified to the Congress as eligible for Nunn-Lugar assistance and Congress has been notified of the U.S. plan to allocate funds for these purposes. A complicating factor for the housing project is the contracting protest lodged with GAO, which must be resolved before an award can be made.

The Report announces new programs such as the OPIC reserve of up to \$500 million in finance and political risk insurance assistance for U.S. private investment in defense conversion in Russian and other NIS, and the special defense conversion program of the Department of Commerce's SABIT business internship program

governments and between potential partners prior to awards, causing the Russians to feel they are not adequately involved in the decision process and to operate on inaccurate or insufficient information; (5) insufficient formal notification to Russia, causing delays in the formation of joint ventures under Russian law; and (6) the necessity for the partners to work out the final terms and conditions, shares and other partnership details of their joint ventures. For example, the Double Cola - NPO Mashinostroyeniya joint venture is still pending due to differences regarding the partners' contributions to the joint venture (see background information sheets).

c. Committee priorities for the future.

1) To obtain Russian understanding that most USG assistance for Russian defense industry conversion in the future will be in the form of facilitating and encouraging private investment and that the Defense Conversion Committee role will be to facilitate these activities.

2) To support the Russian government in moving ahead as quickly as possible with privatization of converting defense firms, especially those associated with weapons of mass destruction. USG programs aimed at economic reform and encouraging the growth of the private sector could play a supporting role in this endeavor.

3) To secure the Russian government's agreement to refrain from interfering in conversion-related joint business initiatives between Russian and Western firms. In terms of Nunn-Lugar defense conversion cooperation, this means allowing IESC advisors and Western firms to visit and obtain information from all the firms on the list of 82. In broader terms, the Russian government needs to remove many obstacles to foreign investment in its defense industries, one of which is excessive taxes on foreign investments. In this regard the Defense Conversion Committee is working with the Business Development Committee, through its Defense Conversion Subcommittee, to remove obstacles to increased private investment and trade.

3. Summary of key points to be made by the Vice President

a. The two sides have made important steps in launching pilot defense conversion projects, but the success of these particular projects and the much larger engagement by Western firms that we hope to spur will depend on the Russian government's ability to move ahead with economic reform, especially privatization of defense firms, the development of an equitable and stable tax code and a market-oriented commercial

code, and removal of legal obstacles and tax disincentives to Western investment in these firms.

b. The role of governments is to facilitate and encourage conversion by removing obstacles to business partnerships. Decisions on defense conversion projects and partnerships are the province of business, not governments.

c. We are willing to facilitate conversion projects which utilize dual-use technologies previously developed by the Russian side by agreeing that they may compete for conversion awards under the Nunn-Lugar program, by providing information on U.S. laws and regulations on commercialization of government-funded research, and by facilitating contacts between U.S. high technology firms and Russian defense enterprises such as a workshop in California planned for early 1995.

d. The U.S. side is stepping up its effort to coordinate our joint defense conversion cooperation with technical assistance programs supporting economic reform and a legal framework supportive of private enterprise. We want to work together with you to coordinate assistance in one defense-dependent city, such as Yekaterinburg.

4. Desired outcome

The U.S. side will assess the meeting as successful if the Russian side endorses the concept that private sector efforts are the key to defense conversion, and that the Defense Conversion Committee's role is to coordinate activities which facilitate private sector efforts, including business directories for the "list of 82" enterprises produced by the Commerce Department. Another sign of success would be the commitment by Russian officials to step up efforts to privatize, or encourage privatized spin-offs from, defense firms on the list of 82.

Talking Points for the Vice President

Defense Conversion Committee Report Session

Introduction:

- Prime Minister Chernomyrdin, I am pleased to present Secretary of Defense William Perry, who heads the U.S. component of the Defense Conversion Committee, and Deputy Under Secretary of Commerce Barry Carter, Secretary Perry's vice-chair.
- I would like to welcome the Russian cochair of the Committee, First Deputy Minister of Defense Andrei Kokoshin and Mr. Valeriy Mikhailov. It's good to meet with you again.
- I understand that since we met in Washington in June, your Committee has made progress toward implementing concrete projects for defense conversion.
- The Clinton Administration believes that successful cooperation in this area will contribute in a major way to social stability in Russia and continued progress with political and economic reforms.
- I am especially interested in hearing what the Committee has done since June to advance this cooperation through practical deeds.

Comments on Conclusion of the Committee Report

- Your report indicates that the Committee has made progress in moving ahead with cooperative defense conversion initiatives.
- OPIC's new program to facilitate private investment in NIS conversion projects with insurance and finance opportunities, the Nunn-Lugar defense industry and housing industry conversion programs, the new Defense Enterprise Fund, the Commerce Department's program of outreach to U.S. industry and SABIT defense conversion internship program, and the initiatives by the Department of Energy and the Arms Control and Disarmament Agency to help weapons scientists reorient to commercial, civilian products are important programs that will spur both Russian entrepreneurship as well as many additional initiatives by U.S. and western private

firms. The Committee's standing working group has been established and has met twice since our last meeting.

- As Secretary Perry has pointed out, these initiatives address only a small portion of the problem your country faces in reorienting its economy to meet civilian needs, and the key engine of this process will be efforts by Russian private firms and foreign partners (including U.S. private companies).

Role of Private Firms

- Private firms have the best access to information about their technologies and production capabilities and about the potential markets for their products.
- The Nunn-Lugar pilot projects, the Russian Business Directories, industry roundtables, a new internship program, OPIC finance and political risk insurance assistance and our other conversion assistance programs are designed to engage U.S. firms with privatized Russian defense firms to develop commercially-viable business initiatives, thus stimulating much more extensive cooperative efforts.
- As Secretary Perry has noted, these cooperative programs already are spurring the interest of U.S. firms. We need to keep up momentum in this area.

Role of Governments

- Clearly, our governments must play a major role in creating the environment in which Russian defense firms, both independently and with the assistance of foreign companies, can develop commercially-viable business initiatives to produce civilian products.
- We need to build on these initial successes and work even more intently and more effectively to get U.S. companies and Russian defense firms engaged in cooperative initiatives.
- As Secretary Perry has pointed out, the U.S. side intends to coordinate our conversion assistance more closely with technical assistance programs supporting economic reform and a legal framework supportive of free enterprise. We intend to begin with a model effort to coordinate U.S. assistance in the city of Yekaterinburg.

- For its part, the Russian government can help by ensuring that U.S. companies and International Executive Service Corps (IESC) conversion advisors are able to visit and assess the commercial capabilities of converting Russian defense firms, by providing comments promptly on the Commerce Department's directories of converting Russian defense firms, by supporting privatization, or privatized spin offs, of firms on the list of 82 firms targeted for our cooperative efforts, and by ensuring the exemption from customs duties and taxes for equipment for Nunn-Lugar defense conversion projects..
- The Russian government also can play a key role in removing obstacles to private initiatives involving the firms on the list and other converting defense firms by:
 - establishing the social welfare network necessary for the successful conversion of Russian defense firms;
 - removing burdensome taxes and tariffs on Western firms involved in joint business initiatives, especially taxes on capital investments and equipment imports needed to convert Russian defense firms to civilian production;
 - establishing an equitable, stable tax code and a comprehensive, market-oriented commercial code;
 - approving the Bilateral Investment Treaty;
 - and, improving legislation covering foreign investment, such as by securities regulation enabling investors to buy and sell shares in companies and by establishing a standard corporate charter to enable company shareholders to participate in management.

Working Group

- The establishment of a standing working group has been a very useful means of advancing the Committee's work and dealing with problems and obstacles on a more timely basis. You have agreed that it should continue to meet on a quarterly basis.
- Clearly, this working group should have a broad focus and be concerned with pushing the Committee's policies forward and helping to remove obstacles. It

should avoid management of individual defense conversion cooperation projects. These decisions must be made by private businessmen, not government officials.

Contingency Talking Points

- Funding for the housing industry and "list of 82" projects (Russians may raise this issue)
 - We hope to fund these activities from FY 95 Nunn-Lugar appropriations. Those funds will be available once Russia is certified to the Congress as eligible for Nunn-Lugar assistance and Congress has been notified of the specific projects and 15 days have lapsed without any Congressional objection.
 - An additional requirement in the case of the housing industry conversion project is resolution of the protest lodged with GAO.
- Dual Use Technologies
 - We have planned several events to facilitate the use of dual-use technologies developed by the Russian side in future defense conversion cooperation.
 - As part of "Urals Day" activities, we organized a December 14 roundtable in Moscow which brought together representatives of American high technology companies and the major defense enterprises located in Yekaterinburg.
 - We are planning a CEO conversion mission that would visit several Russian cities in the spring of 1995.
 - We are also planning a workshop in California to discuss possible defense conversion in the high-technology area.
 - Proposals using such technologies may compete for future Nunn-Lugar conversion awards.

Guidance for the Future

- The Defense Conversion Committee has made good progress, but we can and must do better.

- I would hope that at the next meeting of the Commission, the Committee will report specifically on the following areas:

- How defense conversion cooperative programs have been integrated with broader programs of technical assistance relating to economic and legal reform;

- Specific steps that have been taken to remove obstacles to private investment in defense conversion in Russia.

- Measures of progress in our cooperative programs and in overall defense conversion in Russia.